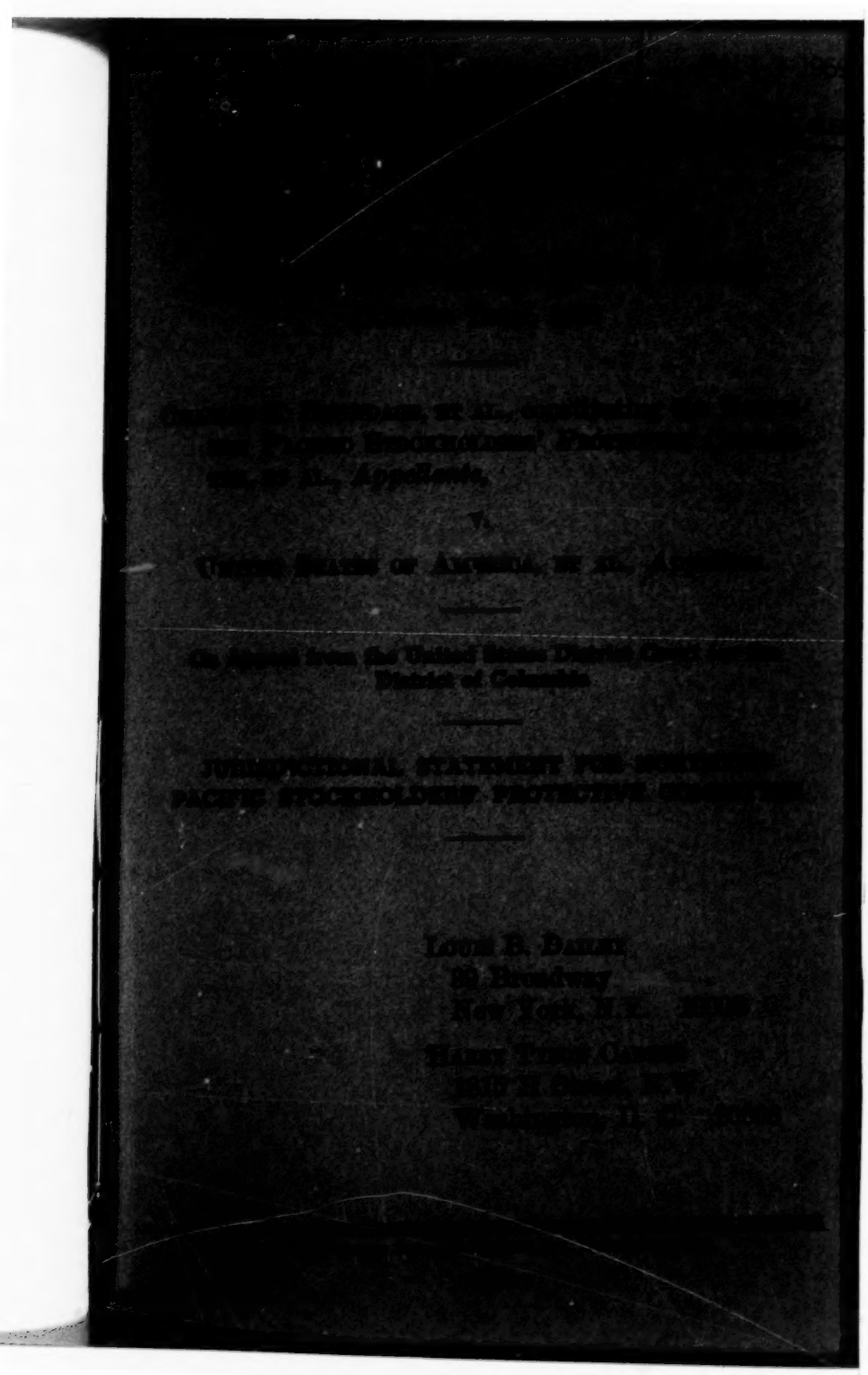

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Supreme Court of the United States

OCTOBER TERM, 1968

No.

CHARLES E. BRUNDAGE, ET AL., constituting the NORTHERN PACIFIC STOCKHOLDERS' PROTECTIVE COMMITTEE, ET AL., *Appellants,*

v.

UNITED STATES OF AMERICA, ET AL., *Appellees.*

On Appeal from the United States District Court for the District of Columbia

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JURISDICTIONAL STATEMENT FOR NORTHERN PACIFIC STOCKHOLDERS' PROTECTIVE COMMITTEE

JURISDICTIONAL STATEMENT

Appellants, Charles E. Brundage, Bradford F. Story, Samuel C. Williams, Jr. and Warren Clark, constituting the Northern Pacific Stockholders' Protective Committee (hereinafter referred to as the "Committee"), appeal from the order of the United States District

Court for the District of Columbia entered on November 20, 1968, dismissing appellants' complaint seeking to suspend, enjoin, annul and set aside certain orders of the Interstate Commerce Commission (hereinafter referred to as the "Commission"), denying the prayers in said complaint and affirming said orders of the Commission, and submit this statement to show that the Supreme Court of the United States has jurisdiction of the appeal and that substantial questions are presented. A copy of the order appealed from is attached as Appendix B to the Jurisdictional Statement for the United States heretofore filed on behalf of the Department of Justice of the United States of America.

OPINION BELOW

The opinion of the three-judge United States District Court for the District of Columbia is not yet reported. A copy thereof is attached as Appendix A to the Jurisdictional Statement for the United States. The several decisions of the Interstate Commerce Commission, copies of which are included in the Appendix to the Jurisdictional Statement for the United States, are reported at 328 I.C.C. 460, 331 I.C.C. 228, 331 I.C.C. 869, and 333 I.C.C. 391.

JURISDICTION

This suit was brought under 5 U.S.C. 701 through 706, inclusive, and 28 U.S.C. 1336, 1398, 2284 and 2321 through 2325, inclusive, to suspend, annul and set aside the orders of the Commission, on reconsideration, dated November 30, 1967 and April 11, 1968 and to obtain injunctive relief. Pursuant to 28 U.S.C. 2325, a three-judge district court was convened. The order of the District Court dismissing the complaint and denying

the prayers therein was entered on November 20, 1968. The notice of appeal was filed in that court on December 20, 1968. The jurisdiction of the Supreme Court of the United States to review this order by direct appeal is conferred by 28 U.S.C. 1253, 2101(b) and 2325. *B. & O. R. Co.* v. *United States,* 386 U.S. 372.

QUESTIONS PRESENTED

1. Whether the District Court erred in holding that there was substantial evidence in the record, which on this point was closed in 1962, to support the Commission's finding and conclusion that the stock exchange ratios of the proposed merger terms are just and reasonable to Northern Pacific stockholders?

2. Whether the District Court erred in holding that there was substantial evidence in the record to support its and the Commission's finding that the stock exchange ratios of the proposed merger are just and reasonable to Northern Pacific stockholders and reflect the full potential value of its natural resources properties now at the time of a possible consummation of the merger?

3. Whether the District Court erred in holding that the Commission did not abuse its discretion in not requiring or permitting the record to be reopened to update it with respect to the valuation of the natural resources properties of Northern Pacific?

4. Whether, in refusing to permit the Committee to update the record with respect to the valuation of the natural resources properties of Northern Pacific, the District Court erred in holding that the action of the Commission was not without observance of procedure required by law?

5. Whether in affirming the orders of the Commission the District Court erred (1) in failing to review the whole record or those parts cited by the Committee, including the extensive, unrebutted, expert evidence offered by the Committee, and (2) in failing to consider and discuss the stock exchange ratios deemed just and reasonable by the Committee based solely on evidence in the record and showing Northern Pacific stockholders to be entitled to more stock of the new company than Great Northern stockholders without provision for any preferred stock?

6. Whether the District Court erred in upholding the orders and decisions of the Commission without specific findings and conclusions by the Commission as to how the stock exchange ratios of the proposed merger were calculated, and the reasons and basis therefor, or how they are justified by evidence in the record?

7. Whether the District Court erred in affirming the finding of the Commission approving the determination of the stock exchange ratios of the proposed merger primarily on the basis of past overall net earnings of Great Northern and Northern Pacific rather than primarily on the basis of a combination of the past earnings from the operations of their respective *railroad* properties and a different method of determining the current market value of Northern Pacific's *natural resources* properties?

8. Whether under Section 5(2) of the Interstate Commerce Act, 49 U.S.C. 5(2), and 5 U.S.C. 556(d) the applicants are required to carry and, if so, have carried the burden of proving that the stock exchange ratios of the proposed merger are just and reasonable to

Northern Pacific stockholders at the time of consummation of the merger?

9. Whether the District Court erred in affirming the finding of the Commission that arm's-length bargaining in the determination of just and reasonable merger terms was a necessary and required test under Section 5(2) of the Interstate Commerce Act and that there was substantial evidence in the record of such bargaining?

10. Whether the District Court erred in upholding the finding of the Commission that evidence that the stock exchange ratios were the result of arm's-length bargaining and had been approved by the stockholders of all of the applicants was sufficient to establish the justice and reasonableness of such merger terms under Section 5(2) of the Interstate Commerce Act without other substantial evidence of the justice of such terms?

11. Whether the District Court erred in holding that the Committee conceded that a definitive valuation of the natural resources properties of Northen Pacific would be difficult if not impossible, and in adopting the Commission's erroneous statement that the Committee did not have a real objection to the undervaluation of such properties?

12. Whether the District Court erred in upholding the Commission's finding that the proposed condition of the Committee involving the segregation and sale (prior to consummation of merger of railroad properties) of the natural resources properties of Northern Pacific to a new land company to the stock of which Northern Pacific stockholders alone would have subscription rights was unfair to Northern Pacific stock-

holders, and whether such finding is not arbitrary and unsupported by substantial evidence in the record?

13. Whether the District Court erred in upholding the Commission's failure to make certain findings requested by the Committee in its Brief before the Commission as to matters material to a determination of the justice and reasonableness of the stock exchange ratios?

STATUTES INVOLVED

The statutes involved in this case are: 5 U.S.C. 554, 556, 557, 704, 706; 28 U.S.C. 1253, 1336(a), 1398(a), 2101(b), 2284, 2321-25; Sections 5(1), 5(2), 5(9) and 5(11) of the Interstate Commerce Act (49 U.S.C. 5(1), 5(2), 5(9), 5(11)). The texts of these statutes are attached hereto as Appendix I.

STATEMENT OF CASE

This is an action to suspend, enjoin, annul and set aside orders of the Commission, dated November 30, 1967 and April 11, 1968 authorizing the consummation of the so-called "Northern Lines" merger involving Great Northern Railway Company ("Great Northern"), Northern Pacific Railway Company ("Northern Pacific") and Chicago, Burlington & Quincy Railroad Company ("Burlington") and other subsidiary companies. This appeal by the Northern Pacific Stockholders' Protective Committee from an order of the United States District Court for the District of Columbia dismissing the complaint and affirming the orders of the Commission is concerned with the stock exchange ratios set forth in the application to the Commission. These are as follows:

Northern Pacific stockholders would receive common stock of the new company on a share for share basis.

Great Northern stockholders would receive common stock of the new company on a share for share basis plus one-half of a share of the new company's $10 par value 5½ percent preferred stock for each share of Great Northern stock held at the date of the merger. The Burlington stock owned by Great Northern and Northern Pacific, totaling 97.18 percent of the total outstanding Burlington stock will be cancelled but the minority stockholders of Burlington will receive 3.25 shares of common stock of the new company in exchange for each share of their Burlington stock. The preferred stock would be retired over a 25 year period beginning at the fifth anniversary of the merger and would be redeemable at the option of the new company after the fifth anniversary of the merger.

This is the fourth attempt by the Northern Lines to merge. The first was turned back in *Pearsall* v. *Great Northern Railway Company,* 161 U.S. 646 (1896); the second in *Northern Securities* v. *United States,* 193 U.S. 197 (1904). In the third attempt, the merger was approved in *Great Northern Pacific Railway Co. Acquisition,* 162 ICC 37 (1930) on condition the applicants divested themselves of control of the Burlington. The third merger was never consummated because of the condition imposed by the Commission.

As a result of land grants from the U. S. Government under an Act of Congress of July 2, 1864 to encourage construction of a transcontinental railroad west from Lake Superior to Puget Sound, Northern Pacific, *unlike the other parties to the merger,* has vast natural resources properties which contain oil and gas, timber, iron, coal and other minerals (Tr. 68-70; 9889-96). Originally Northern Pacific owned 39,473,369 acres of such lands in fee, and it now owns mineral and/or

surface rights in approximately 8,314,000 acres, an area almost equal to that of the States of Massachusetts and Connecticut combined (Tr. 14360; Ex. 36, p. 8; Tr. 9896).[1]

Before undertaking serious negotiation of merger terms, both Northern Pacific and Great Northern separately employed timber and oil and gas experts to value such properties, and Northern Pacific's staff made a "catch-all" appraisal of other mineral and surface rights, assigning no value however to "billions of tons of lignite, subbituminous and bituminous coal" (Ex. 31, p. 2). A summary of these unsworn appraisal reports, dated in 1957, 1958 and 1959 appears in Exhibit 32 at page 18. The values set forth in these appraisals total $202,694,457, including $32,700,000 worth of industrial properties.

In May, 1959, Northern Pacific's financial advisor, Morgan Stanley & Co., recommended that Northern Pacific not merge with Great Northern unless its stockholders received as a minimum a greater per share interest in the new company than the per share interest to be received by Great Northern stockholders with no provision for any preferred stock[2] (Ex. 32, pp. 27-8). Despite this recommendation, the proposed stock ex-

[1] The discovery in 1951 of oil on these lands in the Williston Basin has radically affected Northern Pacific's character, activities and earnings resulting in a separate Oil Development Department and the removal of its stock on March 29, 1952 from the Dow-Jones Railroad Average (Tr. 9895, 9898, 14346). In 1961 more than one-third of the total net income of the Northern Pacific was from these natural resources properties (Ex. 136, p. 19).

[2] Mr. Macfarlane, Chairman of the Consolidation Committee of Northern Pacific, at that time believed the Morgan Stanley report alowed a "wholly inadequate amount for Northern Pacific's natural resources" (Ex. 145, Part I).

change ratios favoring Great Northern stockholders were agreed upon in June 1960 by the negotiators.[3] On February 17, 1961 the applicants filed with the Commission their application for approval of the merger and in April, 1961, the Northern Pacific stockholders, unaware even of the existence of the appraisals of their natural resources properties, by almost the slimmest of all margins in recent railroad mergers, approved the merger.[4]

In August 1961 the Committee was organized, and in October 1961 it intervened before the Commission.

The Committee offered testimony of experts as to many factors applicable in the valuation of the natural resources properties that are not applicable in valuing railroad properties. On the failure of the applicants to offer in evidence even the appraisals which had been obtained or the reports of the financial advisor to the Northern Pacific, the Committee put all of them in the record as evidence that the proposed stock exchange ratios are unfair to Northern Pacific stockholders. The Committee also offered a constructive proposal in the segregation of such natural resources properties.

Applicants' case in support of the justice and reasonableness of the ratios consisted essentially of the argument that the ratios were the result of arm's-length bargaining and had been approved by the directors and

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[3] Both Mr. Macfarlane and the witness for Morgan Stanley & Co. testified before the Commission that there had been no deterioration of Northern Pacific's situation in relation to Great Northern's between May of 1959 and June of 1960 (Tr. 1176; 2472).

[4] An affirmative vote of 66 2/3% of the outstanding shares being required, 73.81% were voted in favor of the merger. The only lower margin of approval was 72.88% by the Erie stockholders.

shareholders of each of the applicants and were, therefore, just and reasonable and that past earnings favored Great Northern stockholders. Applicants offered no expert testimony or other evidence to rebut the direct case of the Committee as to the radically different factors to be considered in valuing natural resources properties than in valuing railroad properties.

The hearings before the Examiner were closed on July 10, 1962.

The Committee's petition for a further hearing, served and filed in June 1963, was denied by an order of the Commission, Division 3, dated July 19, 1963.

The Commission in its first report and order, dated March 31, 1966 (328 ICC 460), disapproved the proposed merger by a 6 to 5 vote on the ground that it was not consistent with the public interest. This decision did not discuss the matter of the stock exchange ratios.

In July, 1966, the Committee served and filed a petition for further hearing seeking to update the record with evidence as to the justice and reasonableness of the proposed merger terms and seeking reconsideration in certain respects, which petition was denied by an order of the Commission on January 4, 1967.

The Commission in its first report and order on reconsideration dated November 30, 1967 (331 ICC 228) approved the proposed merger by a vote of 8 to 2 and substantially adopted its Examiner's findings as to the stock exchange ratios.

The Committee on January 11, 1968 filed a petition for reconsideration and for further hearing on the ground that the record should be updated, particularly as to the valuations of the natural resources properties

of Northern Pacific. This petition was denied by the Commission in its second report on reconsideration dated April 11, 1968 (331 ICC 869), which report also corrected a misstatement as to the Committee's proposed condition involving segregation through a new land company. At a special meeting of stockholders of Northern Pacific called for March 14, 1968 the proposed merger with revised conditions imposed by the Commission was approved by an affirmative vote of 73.20% (66⅔% required).

The Committee then on May 6, 1968 commenced an action in the United States District Court for the Southern District of New York to suspend, annul, enjoin and set aside the orders of the Commission (331 ICC 228) and (331 ICC 869) and for injunctive relief, which relief was denied. By order, dated June 12, 1968, on consent, all further proceedings were stayed pending further order of that court.

After the commencement of a similar action by the Department of Justice of the United States of America in the United States District Court for the District of Columbia, the Committee intervened therein and filed a similar complaint which was heard before a three-judge district court on application for a stay and on final hearing. Said court on November 20, 1968 entered an order dismissing appellants' complaint and denying the prayers therein. In substance the District Court reviewed the findings of the Commission and, on the basis of the record upon which the Commission had relied, sustained the Commission's ultimate finding that the stock exchange ratios were just and reasonable. It also refused to require the Commission to reopen the record to update it.

This appeal followed.

THE QUESTIONS ARE SUBSTANTIAL

We live in an era in which astronauts circle the moon and conglomerate mergers of completely disparate businesses, activities and properties are being put together in the marketplace at a rate and of a magnitude not heretofore dreamed of. These mergers are producing and will produce social, economic and legal consequences of increasing complexity and diversity.

This appeal is a case in point.

In it are presented novel, substantial legal problems involving a new application of the law dealing with mergers of railroad properties under Section 5(2) of the Interstate Commerce Act, together with fundamental and inter-related questions of administrative law under 5 U.S.C. 557 and the scope of judicial review thereof under 5 U.S.C. 706.

The novel problems of fact and law presented by this appeal arise primarily from the fact that the stockholders of only one of the parties to the merger, Northern Pacific, will be contributing to the new company substantial non-railroad properties in the form of interests in lands containing many natural resources such as timber, oil and gas, coal and iron and other minerals, such lands comprising an area almost as big as Massachusetts and Connecticut combined. Were just railroad properties involved, as contemplated by Section 5(2) of the Interstate Commerce Act, this appeal would not be before this court.

The record in this case is inadequate and stale, not as to the railroad properties and operations, but as to the difficult valuations of these vast natural resources properties of Northern Pacific. The proposed merger

terms have so far been approved on the erronoeus assumption that in the marketplace values of both railroad properties and natural resources properties, disparate as they are, are determined by the same method of valuation, to wit, capitalization of past earnings—this in spite of unrebutted, expert testimony that radically different factors are necessarily involved in determining the market value of natural resources properties.

This appeal raises the further substantial question of administrative law as to the nature and scope of the findings which the Commission must make in support of its ultimate conclusion as to the justice of the proposed merger terms.

The correlative problem as to whether on judicial review any special expertise must be accorded the Commission and its decisions in the valuations of non-railroad properties presents a similar substantial question. This appeal has broad implications for other administrative agencies as well as the Interstate Commerce Commission, and becomes increasingly important when measured against the present era of conglomerate mergers.

It is imperative that an authoritative statement of law be made, applicable to these fundamental questions necessarily involved in a resolution of this case.

In addition to the public questions just discussed, there are, of course, large private interests involved. Even a small change in the stock exchange ratios would have a major effect on the dollar value of the holdings of the thousands of stockholders of both railroads. The injustice of denying appellants a fair hearing in seeking to protect their investments is manifest.

Unless probable jurisdiction is noted here, not only will the private interests have suffered irretrievable harm, but also the substantial public legal questions above discussed will not be resolved for future guidance in other mergers that will be "coming down the tracks".

Plainly, the questions presented by this appeal are substantial.

I. THE DISTRICT COURT ERRED IN UPHOLDING THE COMMISSION'S ULTIMATE FINDING THAT THE STOCK EXCHANGE RATIOS OF THE PROPOSED MERGER TERMS ARE JUST AND REASONABLE ON THE BASIS OF THE RECORD BEFORE THE COMMISSION.

The basic error is that the law of *Schwabacher* v. *United States,* 334 U.S. 182, has been misapplied in a unique case in which only one party is contributing vast non-railroad properties. The problem of how to evaluate and reconcile the contributions of radically different kinds of properties by the stockholders of the various parties to the merger has been avoided—not met. The positive, extensive, expert, unrebutted evidence introduced into the record by the Committee and its precise calculations of stock exchange ratios, based on evidence entirely of record, have been ignored—not discussed or evaluated. The proposed stock exchange ratios have been justified largely on the basis that they resulted from so-called "arm's-length" bargaining of the parties and have been approved by the stockholders—not on the basis of supporting findings and reasons relating to the material valuation problem, involving both fact and law presented on the record.

A. The Law of the Schwabacher Case, That It Is the Current Worth or Intrinsic or Market Value of the Contribution of Each Group of Stockholders in the Merger That Must Be Made Good to Them, Has Not Been Correctly Applied in This Case So Far.

At the outset the narrowness of the issue must be pointed out.

The fundamental problem in developing just and reasonable stock exchange ratios in this case is how to reconcile, on balance, the contribution of only railroad properties by one group of stockholders (Great Northern) and the contribution of railroad properties plus natural resources properties by the other group (Northern Pacific).[5]

It is undisputed in the record that the proposed merger terms were based on agreement between the parties on a ratio of 60 to 40 for Great Northern's railroad properties in relation to the railroad properties of Northern Pacific. Undisputed testimony also is in the record that the market value of such properties should be determined by application of a price-earnings ratio of 15 (Tr. 10022). With these conclusions the Committee took and takes no issue (Tr. 9916).

The issue in this case is how the vast natural resources properties, which Northern Pacific stockholders alone are contributing, are to be valued; whether on the same bases as railroad properties dedicated to the public use, or on the basis of many substantially different factors because of the radically different character of natural resources properties.

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[5] The contribution of Burlington stockholders is not discussed since 97.18% of its stock is owned equally by Northern Pacific and Great Northern.

Schwabacher v. *United States, supra,* laid down certain general guiding principles of valuation of the respective contributions in a merger application under Section 5(2) of the Interstate Commerce Act dealing solely with railroad properties. At page 199 in its opinion this Court said:

> "In appraising a stockholder's position in a merger as to justice and reasonableness, it is not the promise that a charter made to him but the *current worth* of that promise that governs, it is not what he once put into a constituent company but what value he is contributing to the merger that is to be made good." (Emphasis supplied.)

Speaking of the Commission's determination of the justice and reasonableness of merger terms and the rights of dissenting stockholders in liquidation under state law, this Court went on to say at page 201:

> "In making that determination, those rights are to be considered to the extent that they may affect *intrinsic or market values.* While the Commission has found that what the appellants are given in this plan is just and reasonable, the record indicates that it may have declined to consider these claims, even if they are found to have some effect on the intrinsic value of the stock, because it thought it lacked jurisdiction. Under these circumstances, we cannot be sure that in arriving at its conclusion that the plan was just and reasonable it did not exclude some factors that it should consider under the views set out in this opinion." (Emphasis supplied.)

The testimony of the Committee's expert witness dealt at length and in depth with numerous factors that must be and normally are considered in the mar-

ket place in the value placed on natural resources properties. Many of these factors are not applicable in the valuation of railroad properties. This testimony on crucial and material issues in the case stands completely unrebutted in the record although representatives of the financial advisors of the parties, First Boston Corporation and Morgan Stanley & Co., and Northern Pacific's oil geologist were available to testify.

Three examples of these factors will point up their importance and materiality: (1) Northern Pacific gets a return annually of more than 100% of the net capital investment in its natural resources properties against a return of only 1.4% in 1960 on the book value of its transportation properties (Tr. 136, 9919); (2) income tax savings from depletion allowances on Northern Pacific's natural resources run into millions of dollars, but no estimates of the amount of such savings were made (Tr. 9919, 10082-3, 2464); (3) the impact of monetary inflation on land values was considered in negotiating the proposed stock exchange ratios only to "a very small degree" (Tr. 1040, 1042, 1348, 1421-2, 2455-7).

The applicants, who bear the burden of proving the justice and reasonableness of the proposed stock exchange ratios, did not even offer in evidence the unsworn appraisal reports concerning these natural resources properties which were obtained and used particularly by Morgan Stanley & Co. in making in 1959 its recommendation of stock exchange ratios favoring Northern Pacific stockholders over Great Northern stockholders (Tr. 91-2). The record contains no testimony of any timber or oil or other geologist except that of the Committee's oil geologist as to favorable future potentials to be expected from the 5½ million acres of

Northern Pacific's lands deemed to have oil and gas potentials (Tr. 10057-71, 1084-6).

Instead of applying the *Schwabacher* legal tests of "current worth" or "intrinsic or market value," the applicants staked their case in support of the merger terms largely on the claim that they were the result of arm's-length negotiations and that they had been approved by stockholders. Past earnings, past stock market values and dividends, and the assumption (proved false by subsequent events) that there was nothing reasonably foreseeable to indicate that Northern Pacific's future earnings prospects were better than Great Northern's were also advanced by applicants.

Rather than face up to the difficult task of determining the current worth or market value of these vast natural resources properties and then reconciling them with the values of the railroad properties, the applicants' position in the record was and is that a definitive valuation of the natural resources properties or of the stocks involved, except on a basis of capitalization of earnings, was difficult if not impossible and that determination of just and reasonable stock exchange ratios had to be a matter of "judgment". The Commission seems to have accepted this erroneous avoidance of the mandate of the *Schwabacher* case, *supra* (See 331 ICC 258-9).

The District Court sustained this error, apparently at least partially on the *mistaken* conclusion that: "The Committee conceded that a definitive valuation would be difficult if not impossible" (p. 45 of App. A to the Jurisdictional Statement for the United States).

The record shows that the Committee Chairman testified that such valuation presented difficulties and that

in his opinion no "exact appraisal" (meaning in dollars) could be made (Tr. 9913, 9925). But the Committee's position throughout has been, and is, that a finding as to the value of what Northern Pacific stockholders are contributing in this merger, in the form of these vast natural resources properties, must be based on underlying evidence as to their current market value. The legal test is not the "judgment" of negotiators acting under "extreme compulsion" to achieve a merger of other assets, to wit, railroad properties (Tr. 144-7, 176, 986-7).

Stockholder approval of the merger, strongly relied on by the Commission and the District Court, is not a criterion involved in the determination of just and reasonable merger terms under Section 5(2) of the Interstate Commerce Act. It is required under Section 5(11) of that Act only as a precondition to the consummation of any merger authorized under Section 5(2). The Commission can only authorize a merger after *it* has independently fixed and determined terms and conditions of merger which it regards as just and reasonable. The statutory test is not what a group of stockholders, who in this case had no knowledge of even the existence of asset appraisals, can be "sold" by management (Ex. 145, Part I), but what an expert Commission with a reliable complete record before it determines to be just and reasonable to all groups of stockholders.

Similarly, so-called "arm's-length" bargaining on which both the Commission and the District Court lay considerable stress is not a statutory criterion under Section 5(2) of the Interstate Commerce Act. What was said in *In Re North American Light & Power Co.*,

170 F.2d 924 (3d Cir. 1948) at page 932, is pertinent here:

> "Thus, the presence of arm's length bargaining is not a decisive criterion, but only one of many factors to be dealt with by the Commission in reaching its conclusions . . . The same should be true where arm's length bargaining is not an ingredient of the plan. See In the Matter of United Gas Corp., D. C. Del. 1944, 58 F. Supp. 501. In either case, *absent an adjudication on the merits,* the fundamental task of the Commission is substantially the same." (Emphasis supplied.)

B. A Serious Question Is Here Presented as to Whether There Is Substantial Evidence in the Record as to the Current Worth or Market Value of the Properties Being Contributed in the Merger, Particularly of Northern Pacific's Natural Resources Properties, To Support the Commission's Ultimate Finding That the Stock Exchange Ratios Are Just and Reasonable.

Common sense as well as the mandate of the *Schwabacher* case, *supra,* dictates that before one can judge the justice and reasonableness of the terms of a merger there must be substantial evidence in the record as to the value of what each stockholder group is contributing therein. See *Atlanta B & C R. Co.* v. *United States,* 37 F.2d 401, 402 (N.D. Ga. 1930).

In presenting a proposed merger transaction for approval by the Commission under Section 5(2) the applicants take the responsibility to decide at their own risk the nature and kind of evidence to be presented in support of their application. *Louisville & Nashville Railroad Co. Merger,* 295 ICC 457, 505. See also *Houff Transfer Inc.* v. *United States,* 105 F. Supp. 851, 855 (W.D. Va. 1952).

The duty of the Commission is to judge the fairness of the terms proposed and, after an independent judgment and analysis of the evidence offered by applicants and intervenors, to require altered terms if necessary to achieve justice under Section 5(2). See *Case* v. *Los Angeles Lumber Products Co. Ltd.*, 308 U.S. 106, 128-9.

It is within the context of the "current worth" and "market value" of the properties being contributed that evidence of justice of the stock exchange ratios must be legally judged under Section 5(2). *Schwabacher* v. *United States, supra.*

In the Committee's opinion this means: What would be determined to be the current worth or intrinsic or market value of the various properties being contributed in the merger in arm's length dealings between parties acting under no compulsion to buy or sell:

The "substantial evidence" required under 5 U.S.C. 706 on judicial review is such relevant evidence as a reasonable mind might accept as adequate to support a conclusion after a full consideration of the entire record including contradictory evidence. *Universal Camera Corp.* v. *National Labor Relations Board,* 340 U.S. 474, 488; *Interstate Motor Freight System* v. *United States,* 243 F. Supp. 868, 871 (W.D. Mich. 1965).

In evaluating the present record to determine whether it contains any such substantial evidence in support of the ultimate finding by the Commission and the District Court that the proposed stock exchange ratios are just to Northern Pacific stockholders, only sufficient highlights will be cited to satisfy this Court that there is here presented a very substantial question.

Were the proposed stock exchange ratios the result of an arm's length deal between independent traders under no compulsion to buy or sell?

The chief negotiators, Mr. Macfarlane and Mr. Budd, had been for many years the respective heads of Northern Pacific and Great Northern (Tr. 53, 154). Their companies had owned equally almost all of the Burlington's stock since 1901 (Tr. 79). They alternated as head of the jointly controlled Spokane, Portland and Seattle Railway Company (Tr. 75). Their offices were in the same building. This was the fourth attempt of their companies to merge. Two of the members of Northern Pacific's negotiating committee and Board of Directors who approved the merger terms, personally held respectively only 400 and 240 shares of Northern Pacific stock; one of them was an officer and director of a foundation which in 1961 held 18,412 shares of Great Northern stock and no Northern Pacific stock; the other was the President of two mutual funds, one of which held 139,700 shares of Northern Pacific stock and no Great Northern stock and the other of which held 13,500 shares of Northern Pacific stock and 46,500 shares of Great Northern stock.

Mr. Macfarlane termed the merger of their *railroad* properties "the *overriding* consideration" in the merger application (Tr. 144-7, emphasis supplied). Mr. Budd testified he and Mr. Macfarlane "felt under *extreme compulsion*" to find a solution because of the need for efficient *rail* transportation (Tr. 176, emphasis supplied).

In minutes of a meeting of the Joint Committee on Consolidation in May 1959 it is reported of Mr. Macfarlane: "He said that he did not see how Northern Pacific could *sell* its stockholders on anything less than a share for share exchange" (Ex. 145, Part I, emphasis supplied). He did—the proposed terms.

When the negotiators ran into the difficult problem of valuing Northern Pacific's natural resources properties and combining their value with the values of their railroad properties, they sought segregation of the former. Finding no viable method of segregation, they decided they must be included (Tr. 89, 97-8) (331 ICC 255, 259). They then "threw in the sponge" on the separate valuation of the natural resources properties and claim of record that a definitive valuation (whatever "definitive" means being undefined in the record) was "difficult if not impossible" except on the basis of earnings and that fair merger terms are a matter of "judgment" (Tr. 117-8). Thus, from the record it is clear that the extreme compulsion to achieve a *railroad* merger resulted in an avoidance of the difficult valuation problem.

Perhaps the comments in *Soo Line Railroad Company* v. *United States,* 280 F. Supp. 907 (D. Minn. 1968), at pages 919 and 921, which involved the question of evidence of traffic diversion, best describes what has transpired in this *Northern Lines* case:

> "We fully understand that the task of the Commission in determining potential diversion is a difficult and complex one, and that future events may prove that the Commission's findings were wide of the mark. But the very fact that these are difficult and complex matters makes it all the more necessary for the Commission to use its expertise, but use it it must.
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> . . . . . .
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> "We recognize the difficulty in making these determinations and the natural inclination to escape them by avoiding specific findings and leaving as many issues to negotiation between the parties as possible. When this is done, however, effective judicial review is impossible."

The applicants put in evidence no asset valuations of the natural resources properties, no testimony of any experts on land values, mineral rights, timber, oil and gas and other minerals and their potentials. They rely on a comparison of past overall net earnings up to 1961, dividends and stock market quotations. In capitalizing net earnings they in no way distinguish between the quality of earnings from railroad properties and that from natural resources properties.

On cross-examination, however, the witness for First Boston Corporation, Great Northern's financial advisor, testified that in his opinion natural resource earnings were worth in the market place 1½ times as much as rail earnings (Tr. 2572, 2574-5). There was no issue in the case that a price-earnings ratio of 15 for rail earnings is a fair method of capitalization (Tr. 10022).

Far from making an affirmative case on valuation, applicants failed even to offer rebuttal evidence to the extensive case made by the testimony of witnesses for the Committee, all experts in their fields, dealing with various factors considered important in the market valuations of both railroad companies and natural resources companies, including such evidence as comparative sales of natural resources companies, high price-earnings ratios applicable to natural resources income, and oil prospects of the Williston Basin. The Committee introduced the only exhibits involving valuations. There is nothing in the record to show that the Commission and the court below have given to our expert, unrebutted, contradicting evidence that full consideration required under the applicable law.

In short, the entire record presents questions of material facts and important law not yet considered below.

C. The Decision of the Commission Fails To Include Adequate Supporting Findings and Conclusions as to the Valuations of the Properties Being Contributed in the Merger and To Set Forth Any Intelligible Rationale or Basis for Its Finding That the Stock Exchange Ratios Are Just and Reasonable to Northern Pacific Stockholders.

Before the Commission has discharged its duty under 5 U.S.C. 557, it must make findings on material facts at issue and then give reasons which a reasonable mind might accept applying the pertinent law to the circumstances and facts of the particular case so as to make intelligible to any reviewing court the basis and rationale of its decision. *Louisville & Nashville R. R. Co.* v. *United States,* 268 F. Supp. 71 (W.D. Ky. 1967); *Missouri Pacific R. R.* v. *United States,* 203 F. Supp. 629 (E.D. Mo. 1962); *Northeast Airlines* v. *C.A.B.,* 331 F. 2d 579 (1st Cir. 1964); *Interstate Motor Freight System* v. *United States, supra.*

In valuing stock of a company being contributed in a merger it is imperative for the Commission to make a finding as to the value of underlying property of the company to support the valuation of such stock.

Unless the record contains evidence of the value of underlying properties and the decision makes findings thereon no reviewing court can sensibly judge the ultimate finding as to the fairness of the proposed stock exchange ratios. The District Court here upheld the Commission's ultimate finding without discussion of these material facts and issues.

The decision of the Commission fails to sustain its ultimate finding that the exchange ratios are just by any discussion or analysis of the evidence in the record except by stating the general conclusions that the ratios were "the results of arms' length bargaining" and

"fairly reflect the contributions of each group of stockholders" (331 ICC 260).

The Commission describes the course of the negotiations and some of the contentions of the parties and states its broad conclusions (331 ICC 255-60). However, it wholly fails to analyze the evidence and show what method of valuing the contributions of the various stockholder groups in the merger has been adopted by it: whether primarily by capitalization of past earnings, or by asset valuation, or by a combination of both depending on the type of asset being contributed. If capitalization of earnings is deemed to be the proper method of valuation, what price-earnings ratios applied to both railroad and non-railroad earnings? Or, if the earnings were treated differently, what price-earnings ratios were used? How were these values of different properties combined and put on a common basis so as to justify and satisfy a reasonable mind that the particular stock exchange ratios proposed are just and reasonable? It is not clear from the Commission's decision whether or not it approves the theory of the applicants that a "definitive" valuation of natural resources properties is "impossible".

Likewise, a careful reading of the Commission's decision will not disclose: (1) whether it adopts or rejects the testimony of the Chairman of the Committee (Tr. 9918-22) as to the various factors bearing on the quality of earnings deemed pertinent in the market place in the valuation of natural resources properties (as distinguished from railroad properties) such as the risk involved, the permanence and stability of earning power, the relation of earnings to capital investment, growth factors, future potentials, and the strategic, intrinsic, protective and survival values (as a hedge

against monetary inflation) of land ownership; (2) whether it adopts or rejects the chairman's testimony (Tr. 9913-15) criticizing as fallacious and erroneous the methods and bases of valuation on which the financial advisor of Northern Pacific based its recommendations to Northern Pacific as to what stock exchange ratios would be just and reasonable; (3) whether it adopts or rejects the testimony of Mr. Williams (Tr. 9982-91), a member of the Committee, of comparative sales and comparisons of the values of the stocks of companies owning large acreages of developed and undeveloped land having oil and gas potentials and whose stock is publicly traded; or (4) whether it adopts or rejects the estimates by the Committee's oil geologist of the future oil and gas potentials of Northern Pacific's holdings (Tr. 10062-4).

This vagueness and imprecision of the Commission contrasts strongly with the Committee's awareness of the caveat to a stockholder group in *Erie R. Co. Merger,* 312 ICC 185, where at page 242 the Commission said:

> "Neither the record nor any pleading presented by the dissenters offers any suggestion of precise inequities of the agreed plan, and no alternative plans are submitted for the guidance and consideration of the Commission."

The Committee has not avoided the difficult task of combining and reconciling the values of railroad and non-railroad properties being contributed in the merger in order to calculate with some precision, and on several bases, stock exchange ratios which would appear to be just and reasonable. These calculations, set forth in Appendix II hereto, were also appended to the Committee's Exceptions to the Examiner's Report and to the Committee's Brief before the District Court and

were thus available to the Commission before its decision (331 ICC 228) and to the District Court. These calculations show a range of stock exchange ratios favoring Northern Pacific up to 1.582 to 1 without provision for any preferred stock. *It is the only place in this voluminous record where there are any such rational calculations. Yet neither the applicants nor the Commission nor the District Court have at any time criticized or even commented upon these calculations.*

Only when the Commission's decision is read having in mind the entire record, including opposition evidence, does the failure of the Commission in this unique case to make adequate supporting findings and conclusions and to state an intelligible rationale for its ultimate conclusion as to stock exchange ratios become really exposed to view.

The District Court has erred in its judicial review in not requiring the Commission to correct these deficiencies in the record. This substantial question is now presented to this Court.

D. On Judicial Review the Courts Are Not Required To Accord to the Commission Any Special Expertise in the Valuation of Non-Railroad Properties.

The Commission's treatment of this case exhibits no expertise in the valuation of Northern Pacific's natural resources properties. The cases mentioning the expertise of the Interstate Commerce Commission all refer to its expertise in matters pertaining to the "transportation industry". See *Stott* v. *United States*, 166 F. Supp. 851 (S.D. N.Y. 1958). The District Court in that case was reviewing and sustained the Commission's decision as to stock exchange ratios in *Louisville*

& Nashville R. R. Co. Merger, supra, in which the Commission considered and made comparisons as to 18 different factors relating solely to railroad properties. Here the Commission in its decision did not discuss (or consider, as far as can be seen) the 8 or so factors, covered in the testimony of the Committee's chairman, bearing particularly on the valuation of natural resources properties.

Thus, this appeal presents the substantial legal question as to the extent to which the reviewing court must defer to the findings of the Commission as to a non-railroad matter.

II. THE DISTRICT COURT ERRED IN HOLDING THAT THE COMMISSION'S ACTIONS IN NOT GRANTING FURTHER HEARING TO ALLOW REOPENING OF THE RECORD TO UPDATE EVIDENCE BEARING ON THE JUSTICE AND REASONABLENESS OF THE STOCK EXCHANGE RATIOS WAS NOT WITHOUT OBSERVANCE OF PROCEDURE REQUIRED BY LAW.

The record was reopened, and a further hearing held in the spring of 1968, to update it with reference to the estimated savings that might result from the merger of railroad operations and properties. The original Wyer railroad report (Ex. 4) had already previously been updated. Evidence of relatively minor fluctuations resulted. By the same token that a current record is necessary to sustain a finding as to whether the proposed merger is consistent with the public interest under Section 5(2) of the Interstate Commerce Act, so is it necessary to have a current record to determine the current worth of the contributions of various stockholder groups to arrive at just and reasonable stock exchange ratios under the same Section 5(2).

That the justice of the stock exchange ratios must be determined as of the date of consummation of the

merger when the old shares must be surrendered for shares in the new company is well settled law. *Schwabacher* v. *United States, supra; SEC* v. *Central-Illinois Corp.*, 338 U.S. 96. Such a determination of "current worth" requires a current record. Since changes in facts as to earnings and other statistical data and circumstances and conditions are bound to occur during any protracted agency proceeding, concededly more than normal fluctuations must have occurred before the Commission can properly be held to have abused its discretion.

The District Court here erred in finding that the available new evidence was merely of "normal fluctuations" (P. 46 of App. to Jurisdictional Statement for the United States). It is not a matter of the "arguments pro and con" as stated by the District Court, but rather of the nature, cogency and materiality of the evidence proffered.

In this case the substantial question presented is whether the law of *Atchison, Topeka & Santa Fe Railway Co.* v. *U. S.*, 284 U.S. 248, is applicable. There in a case argued in 1931 the matter was remanded to reopen the record to admit evidence of the economic depression which had scarcely begun. Here the record must be reopened to show the impact on values resulting from economic inflation long in process. There the interval involved after the close of the hearings was slightly more than 2 years; here it has been over 6 years since the record was closed.

The present record shows that in negotiating the proposed stock exchange ratios prior to June 1960 the negotiators only "to a very small degree" considered

the factor of the possible impact of monetary inflation on the market value of Northern Pacific's vast land holdings (Tr. 1040, 1042, 1421). The testimony in 1962 of the Committee's expert on this matter now seems prescient (Ex. 146 and 147).

But a basis for a further hearing even more important than sharp inflation existed when in 1968 our Committee was denied such a hearing. "Hindsight" evidence as to earnings and other factors is not only proper but required to determine "current worth".

A brief indication of some of the evidence now available should suffice to show that the Commission abused its discretion in this case.

The excess of Great Northern's net income, as reported to the Commission, over Northern Pacific's in 1952, the first full year after the discovery in 1951 of oil on Northern Pacific's lands in the Williston Basin, was $11,883,493 (Ex. 26, p. 13). Over the intervening years this excess has been gradually, though irregularly, reduced until it disappeared in 1967 when Northern Pacific's net income exceeded that of Great Northern by $4,132,304 (Supplemental Proxy Statement of Northern Pacific special stockholders' meeting called for March 14, 1968, pp. 9 and 15). Published earnings for the first 9 months of 1968 show Northern Pacific's net income exceeding that of Great Northern by $2,612,198. (Moody's Investors Service Transportation Manual, 1968) This "turn-around" in net income in favor of Northern Pacific is due primarily to the increasing gradual upward *trend* (not fluctuations) of the gross revenues and net income from its natural resources properties, both of which figures hit new all

time highs in 1967 (Supplement Proxy Statement, supra, pp. 2 and 3). Figures on such gross revenues and net income from natural resources have not yet been published for the first 9 months of 1968.

During the 18 trading days in the month of December, 1968 Northern Pacific stock closed higher than Great Northern stock on 13 of those days; lower on 4 days and even on 1 day. This was in spite of the possible consummation of the merger in the near future on terms which favor Great Northern stockholders to the extent of one-half share of $10 par 5½% preferred stock of the new company and in spite of Great Northern's larger dividend rate. Northern Pacific dividends since 1960 have been increased from $2.20 to $2.60 per share, the ceiling imposed by the existing merger agreement, while Great Northern's dividends are still $3 per share, representing a much higher percentage dividend payout from earnings than Northern Pacific's.

This evidence invalidates most of the bases on which the proposed stock exchange ratios were sought to be justified in the present record, namely, (1) higher earnings of Great Northern (Tr. 119); (2) "nothing reasonably foreseeable to indicate that Northern Pacific's future earnings prospects are better than Great Northern's" (Tr. 119-20) and (3) Great Northern's higher dividends and market value (Tr. 121).

As Chief Justice Hughes said for a unanimous court in the *Atchison* case, *supra,* at 262:

> "In the instant proceeding, the hearing accorded related to conditions which had been radically changed, and a hearing, suitably requested, which would have permitted the presentation of evidence relating to existing conditions, was denied. We

think that this action was not within the permitted range of the Commission's discretion, but was a *denial of right.*" (Emphasis supplied.)

It is the current worth of these properties in 1969—not their worth in 1960—that must be considered in determining stock exchange ratios that are just and reasonable. Under the proposed merger terms it would take 30 years after consummation, on complete retirement of the preferred stock, for Northern Pacific stockholders even to achieve parity with Great Northern stockholders. How can stock exchange ratios agreed on in 1960 favoring Great Northern stockholders be deemed just and reasonable to Northern Pacific stockholders in 1969 under the present state of facts?

This available evidence on many crucial matters goes to the very heart of the justice of the proposed stock exchange ratios. It represents trends—not fluctuations. To allow the present stale, misleading record to stand is not only a denial of due process to at least Northern Pacific stockholders not in favor of the merger, but also a dereliction of duty on the part of the Commission to present an adequate record to a reviewing court.

Thus, this action of the Commission in denying a further hearing presents yet another substantial question.

III. THE COMMISSION ERRED IN FINDING THAT THE COMMITTEE'S PROPOSED CONDITION FOR THE SEGREGATION AND SALE OF NORTHERN PACIFIC'S NATURAL RESOURCES PROPERTIES PRIOR TO CONSUMMATION OF MERGER OF RAILROAD PROPERTIES WAS UNFAIR TO NORTHERN PACIFIC STOCKHOLDERS.

The President of the Northern Pacific testified that the ownership of the natural resources properties was not essential to the operation of the company as a railroad and that its railroad operations had not been adversely affected by the past extensive sales of these land grant lands (Tr. 14345). The record is clear that segregation was sought in the negotiations of the merger terms and that it was abandoned only when the negotiators could think of no viable method of segregation (Tr. 98). They never considered a plan involving a sale as proposed by the Committee (Tr. 1042, 1045-6, 1165, 14344-5, 1425, 2432, 2435-6).

The Committee offered the proposal as a constructive means of achieving segregation. The effect of the proposal on the merger would be merely to substitute cash for these properties in the hands of the new company.

The terms of the proposal were not considered by the Examiner and the Commission even sufficiently seriously to be understood. It was not until the order of the Commission on April 11, 1968 that it corrected this matter (331 ICC 888). The finding of the Commission that the proposal has no merit and is unfair to Northern Pacific stockholders (331 ICC 259) is not based on the record. Far from freezing out any Northern Pacific stockholder from continued ownership of natural resources as found by the Commission, Mr. Macfarlane stated in the record (Tr. 14350-54) that, contrasted with the loss of a one-half interest in these properties required by the proposed merger terms, each

Northern Pacific stockholder under the proposal would have a flexible option to apportion his investment between railroad and natural resources properties in any way that he individually might determine, always being able by sale of some of his Northern Pacific stock to have cash available for investment in the land company. Alternatively, Northern Pacific stockholders would have valuable rights which they could sell in the market at prices reflecting the then current values.

Neither of the two mortgage trustees nor Mr. Macfarlane, a lawyer, could point to any mortgage provision (Ex. 145, Part B) which made a sale of these lands illegal (Tr. 14370, 14445, 14461), admitting that approximately 39,000,000 acres of land grant lands had been reduced by sales to Northern Pacific's present interests in approximately 8,300,000 acres.

Objection was made as to the range of the proposed purchase price contained in the proposal but Mr. Macfarlane admitted on cross-examination that the price suggested was approximately the value thereof fixed in determining the present merger terms, plus an approximate amount of capital gains resulting from the sale (Tr. 14358). Even if on an updating and broadening of the record on the valuation of these properties a higher price were deemed to be fair by the Commission, it could appropriately alter the proposed condition as present values might warrant.

In short the finding of the Commission on this matter of segregation is completely unsupported by the entire record and the failure of the District Court even to discuss it in its opinion shows that a substantial question is presented on the basis of the present record.

If for any reason this Court should not deem this question of segregation a substantial one, appellants

respectfully call the Court's attention to the testimony of the Committee (Tr. 9925) that Northern Pacific stockholders should receive vis-a-vis Great Northern stockholders a minimum stock of the new company in a ratio of 1.5 to 1 without any provision for preferred stock.

CONCLUSION

For the foregoing reasons, probable jurisdiction of this appeal should be noted and the case set down for full hearing on the merits.

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